

# THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

Copyright © 2023 Fipecafi. Todos os direitos reservados.

DOI: <https://doi.org/10.53826/2763-7069.v2n4.2021.id477>

**Fabio Pereira da Silva**

FIPECAFI

blogsuaeconomia@gmail.com

**Reinaldo Guerreiro**

Universidade de São Paulo (USP)

reiguerr@usp.br

**Denis Mângia**

Universidade de São Paulo (USP)

denis.maciel@usp.br

## ABSTRACT

The Financial Accounting Standards Board (FASB) published the Interpretation Number (FIN) 48, with the aim to clarify the tax accounting criteria of corporate profits. By requiring greater transparency of tax positions, this interpretation has been regarded with some suspicion by the market. It has been theorized that companies may adopt less aggressive tax practices, which might result in an increased amount of tax payable on profits. On the other hand, according to the Theory of Political Costs, increasing calculated profits might draw the political class's attention. The general aim of this paper is assessing the decision made by Brazilian companies that undergo the referred interpretation, addressing this trade-off by means of a research question: "What is the position taken by Brazilian companies when faced with the obligation to comply with the FIN 48, considering the increased risk of tax audits, from the perspective of the Theory of Political Costs?" Two hypotheses were tested concerning the impact of adopting this interpretation on the amount of taxes evidenced by a sample of Brazilian companies listed on the New York Stock Exchange (NYSE); the results showed that this interpretation does not influence the behaviour of these companies regarding the disclosure of their tax positions. Such results can serve as a prediction about the adoption of International Financial Reporting Interpretations Committee (IFRIC) 23 in Brazil.

**Keywords:** FIN 48; Tax transparency; Theory of political costs.

## Introduction

The Financial Accounting Standards Board (FASB) published the FASB Interpretation Number (FIN) 48 in June 2006, which aimed to clarify the provisions of the Statement of Financial Accounting Standards (SFAS) 109. This document addresses accounting for taxes on profits, including tax accounting and reporting criteria of profits, especially when related to positions that involve uncertainty disclosed in their financial

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

statements. The FIN 48 primarily focuses on increasing transparency in companies' financial statements regarding their tax position, and it is considered by many as the most significant change in the last decade in accounting methods that involve taxes on profits (MILLS; ROBINSON; SANSING, 2010).

The SFAS 109 contains no specific accounting criteria related to taxes on profits under these situations of uncertainty. Thus, divergent accounting practices were adopted as a result of inconsistency in the criteria used to recognize and measure tax benefits related to taxes on profits. This environment of uncertainty reduced the comparability of active and passive tax positions for organizations and made it easier to adopt aggressive practices aimed at reducing the tax burden.

In this scenario, the FIN 48 has emerged in order to make accounting and tax position disclosure converge providing those interested in the statements with more information about the risks of tax practices adopted by companies, increasing transparency, and contributing to the decision-making process. As a result of these new requirements, the FIN 48 has been received with distrust, as it brought out the awe that disclosed information might be used by tax authorities to trigger enforcement action (BLOUIN *et al.*, 2007; KERN; LUTTMAN, 2011).

In Brazil, the feeling is not different; when the standard was issued, the local business press captured some disagreement in the interpretation of its potential effects, however stressing a dread similar to that shown by the U.S. market, in the sense that the standard might facilitate inspection procedures by tax authorities (GOULART, 2007). Thus, while some experts thought that the standard would not produce impacts on the Brazilian companies' balance sheets, others held a different view, predicting consequences in their financial statements as a result of this concern. It is worth noticing that since 2007 the U.S. Securities and Exchange Commission (SEC) started accepting financial statements by foreign private issuers that are prepared based on the International Financial Reporting Standards (IFRS), as published by the International Accounting Standards Board (IASB), without reconciliation to the U.S. generally accepted accounting principles (U.S. GAAP) (SEC Release no. 33-8879/2007). However, many Brazilian companies continued using the FASB standard and, as consequence, they had to comply with the FIN 48.

It is also important to add that more recently Brazil started to adopt IFRIC 23 which, simply by comparison, has similar content to FIN 48, insofar as it requires disclosure of tax positions that are considered uncertain, renewing the fear that the demand for greater transparency has the consequence of increasing the tax risk of companies.

Therefore, considering this rather strict disclosure of their tax positions, especially in face of situations of uncertainty, many corporations may choose to adopt rather conservative tax practices, precisely due to dread of undergoing inspection or adjustment procedures related to tax planning practices. Also, it is not unreasonable to recognize the possibility of occasional devaluation of their stocks, resulting from the disclosure of information that suggest risks to investors, a hypothesis aligned with the Efficient Market Theory, according to its semi-strong form, as proposed by Fama (1970). Consequently, the requirement for greater transparency might have as a hypothetical effect more prudence by the company's administration, thus an increased amount of taxes on profits might also be expected. On the contrary, profit increase may result in warning the local

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

government about too much success with these companies, bringing undesirable effects, like those predicted by the Theory of Political Costs, as proposed by Zimmerman (1983). Hence, the FIN 48 posed a trade-off for companies concerning the right behaviour to choose.

So, this study resorted to a research question to address the issue: “What is the position taken by Brazilian companies when faced with the obligation to comply with the FIN 48, considering the increased risk of tax audits, from the perspective of the Theory of Political Costs?” This study aimed to assess whether the FIN 48 has caused impacts on the amount of taxes on calculated profits by Brazilian companies subject to its adoption and analyse the attitude taken by the Brazilian companies under the paradox: either to pursue less aggressive tax practices in order to avoid warning authorities about the uncertainty of these companies’ tax positions; or pursuing rather aggressive practices in order to avoid increasing profits and prevent drawing government’s attention to success achieved with these corporations, as proposed by Zimmerman (1983).

### Study Justification

When the FIN 48 was issued, conjectures about the consequences of its application emerged in the press – and the scenario was not different in Brazil (GOULART, 2007)<sup>1</sup>. As this interpretation requires greater fiscal transparency, its issuance brought concerns to companies – it may serve as a vector so that tax authorities conduct tax audits, as they have a roadmap of these companies’ tax positions that might facilitate inspection procedures (FRISCHMANN; SHEVLIN; WILSON, 2008). This issue is addressed by Blouin *et al.* (2007), Gupta, Mills and Towery (2009), Mills, Robinson and Sansing (2010), who point out that the interpretation is strict concerning the disclosure of companies’ tax positions, implying an increased probability of audit by government authorities. Blouin *et al.* (2007) even theorized that the adoption of the standard would represent an increase in the tax burden for companies.

Also, this research aims to contribute to discussing the paradox created by the standard regarding political cost. This is so because disclosing tax positions that may be subject to scrutiny by tax authorities might result in a companies’ tendency to adopt less aggressive tax practices. However, the use of conservative tax methods would lead to an increase in profits reported by companies, which may draw government’s attention, a consequence addressed by the Theory of Political Costs (ZIMMERMAN, 1983). Accordingly, there is a clear conflict of choice between the risk of suffering any consequences arising from tax audits and paying for the political cost of disclosing high profits due to the adoption of conservative practices.

In this context, to understand the accounting practices, especially those involving tax issues, it is worth analysing their actual impact on the financial statements of corporations’ subject to the standard – if there is any. This is so because of the current trend of discussion about increasing transparency in accounting information, thus studying

---

<sup>1</sup> It is important to note that, as mentioned by Tomahara, Lee and Lee (2012), the standard affects all companies subject to the preparation of financial statements under USGAAP, therefore it has implications in all jurisdictions, including in Brazil in the case of companies registered in the SEC. According to the authors, due to this scenario, local authorities can make use of the information disclosed, increasing the risks related to the adoption of aggressive tax practices.

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

the impact of the FIN 48 is relevant to grasp the accounting practice. Also, tax information transparency is a current and noteworthy challenge, especially when considering the growing integration of national economies and markets (OECD, 2015). The study is likewise important in Brazil due to the recent adoption of the IFRIC 23, whose content is similar to FIN 48.

In this regard, it is known that the Organisation for Economic Co-operation and Development (OECD), with the political support of the G20, introduced the action plans on base erosion and profit shifting (BEPS) – whose purpose is fighting the erosion of the tax base practiced through international tax planning, especially in terms of the artificial shift from profits to low or no-tax locations.

Among the action plans on BEPS, attention is drawn to the ‘Action Plan 12,’ which deals precisely with the requirement for taxpayers to disclose their aggressive tax planning. In other words, it is an action plan whose content closely resembles the FIN 48 and IFRIC 23, revealing the importance of addressing the theme, especially if we consider that the U.S. standard and its effects are paradigmatic for discussions within the scope of BEPS.

Although the FIN 48 was issued in 2006 and even though it achieved great prominence in the U.S. accounting academy, many studies are still at the working paper level. Additionally, there are few studies that assess the effects on the amount of taxes on the income collected by companies, as mentioned by Tomahara, Lee and Lee (2012), which identified most studies restricted to impacts on the transparency of reported financial statements. This demonstrates that the theme has matured and indicates that this study may also contribute to its discussion outside the U.S. context, placing a developing country under the spotlight, especially considering the current discussions within the scope of BEPS and the adoption of IFRIC 23 by Brazil.

### Literature Review

#### *Studies on the FIN 48*

The FIN 48 primarily aims to standardize accounting concerning tax benefits regarded as uncertain and require companies to disclose the amount of their tax reserves (BLOUIN *et al.*, 2007). Thus, it seeks to increase the accounting information quality and reduce the differences between adopted practices for the benefit of comparability (FRISCHMANN; SHEVLIN; WILSON, 2008).

Lev (2008) summarizes the requirements of this standard claiming that taxpayers are initially responsible to estimate each fiscal obligation not realized, assuming that their tax positions will be audited by tax authorities, which should have all significant information at stake. Thus, the standard removes from the corporate decision-making field the assessment of risk for an audit. Subsequently, it is a responsibility of each taxpayer to determine if it is more likely than unlikely to get a ‘yes,’ so that a tax position is accepted by tax authorities, or they benefit from an occasional administrative/court dispute. The last stage refers to measurement, *i.e.*, the tax position that covers the recognition criteria will be measured to determine the value to be taken into account in financial statements.

Therefore, the FIN 48 determines that a tax position is only recognized and kept in the balance sheet if it is more likely than unlikely to do so, either as an asset or a liability,

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

in case of any inspection procedure. As a result, for each reporting period, companies must evaluate how much of the benefits that may be assigned to uncertain tax positions should be recognized in their financial statements (BLOUIN; ROBINSON, 2013).

Briefly, it may be claimed that the FIN 48 requires companies to adopt strict criteria to disclose the tax position related to taxes on profit. Thus, if the company believes that in an occasional inspection, audit, litigation or assessment a particular event is very likely to be opposed, this must be recognized in the balance sheet, and there is also a need for transparent disclosure of the tax practice adopted.

Several surveys were conducted in order to empirically assess the FIN 48 impact on U.S. companies' behaviour and accounting statements. Most of the results show some kind of behavioural change among companies (BECK; LISOWSKY, 2014).

Gupta, Mills and Towery (2009) found that there is evidence confirming the thesis that companies have implemented some procedure in order to reduce the impact of adopting this standard. The findings point out that, due to the FIN 48, some companies sought the settlement of uncertain tax positions and even reduced tax planning practices. Robinson and Schmidt (2013) observed a decreased level of compliance with the FIN 48 and smaller specific disclosure by companies that engage more intensively to tax avoidance practices.

Blouin and Robinson (2013) state that the findings of academic studies on the subject show that this standard improved comparability between companies. According to these authors, besides providing improved information to investors, it is emphasized that companies' behaviour has changed as a result of this standard, making them more conservative with regard to tax planning. On the other hand, it is worth noticing that the Financial Accounting Foundation (FAF), a private and independent entity that, among other activities, conducts studies on the FASB standards, did not identify empirical evidence to confirm this claim.

Song and Tucker (2008) empirically found that, for highly profitable companies having tax reserves above average, leverage has significantly increased within the 2-year period that preceded the FIN 48 creation. These authors conclude that companies employed substantial discretion to register tax reserves and that many of them did so only to meet analysts' forecasts or to hide revenues. The issue of this standard, however, led to increased cost of reserves, because companies are afraid that inspections may be intensified, prompting the removal of excessive reserves. So, by reducing them, there might be a profit increase. As a result of this context, companies with excessive reserves tend to reduce them before the FIN 48 comes into force, to mitigate supervision scrutiny on their tax positions and/or increase profits.

Lisowsky, Robinson and Schmidt (2013) reported empirical evidence indicating that, in compliance with the FIN 48, there is a positive correlation between the use of tax strategies aimed at reducing the tax burden – as in the case of merged companies in tax havens – and reserves established due to risks of planning. The authors make an exception, however, that this finding is not related to conservatism. Carrying out a similar study, Lisowsky (2010) also concluded that after the FIN 48 adoption this positive relationship became more fragile, suggesting some impact of this standard on companies' tax reserves, although it is not significant, motivating the recommendation to be careful about the implication of results.



## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

Dubin and Watts (2009) also noticed a significantly increased disclosure of income tax positions when compared to sales tax, which is not subject to the FIN 48 provisions, indicating companies' concern to comply with this standard.

In an unprecedented study, as it effectively assesses the effect of the rule on the amount of taxes paid by companies, Tomahara, Lee and Lee concluded that the rule resulted in an increase in the tax burden for large companies, while the effect was not significant for small companies. According to the authors, the result can be explained by the fact that large companies have more resources available to carry out strategic tax planning, as well as being more subject to scrutiny by the tax authorities, so that, by increasing the transparency of disclosures, there is an increased risk of being audited.

In short, most of the academic research concludes that this standard affected U.S. companies' behaviour, and they tend to recognize the impact on the tax burden as a result of the novelty represented by the FIN 48 – the latter statement is disputed by some studies.

However, there are results pointing out non-significant behavioural changes among companies. Nichols (2008) states that a large amount of companies disclosed various tax positions after the standard came into force. The author also claims that, although there is some dread that the FIN 48 represents a shortcut to tax audits by government agencies, evidence shows that the demand for greater disclosure did not result in the presentation of potentially revealing information in this regard, when comparing the current period to that previous to the FIN 48.

Mills, Robinson and Sansing (2010) show that companies with a robust tax position had higher returns than expected after the standard came into force, with no negative impact due to its adoption, suggesting these companies are not disadvantaged by greater transparency, contrary to what happens to those whose tax positions are difficult to sustain to the tax authorities. Even taxpayers with weaker tax positions were not necessarily affected by the standard, although greater transparency may provide the government with a perfect roadmap, suggesting a low standard's impact.

Blouin *et al.* (2007) noticed non-significant changes related to small adjustments, which may indicate that the FIN 48 did not affect companies' behaviour regarding the transparency in their fiscal positions.

The Financial Accounting Foundation (FAF) itself released the *Post-implementation review report*, in January 2012, indicating that its researchers found that "few preparers changed their tax strategies for FIN 48 reasons" (FASB, 2012), even though the standard provided greater corporate tax transparency. This reveals that consequences of the standard's imposition are still contradictory.

In short, although most studies conclude there has been some kind of change in the behaviour of firms under the FIN 48, others state the contrary or suggest that the effects were not significant, pointing out the need for further research, including other methodologies and companies located in other economic scenarios, thus providing a better understanding of the standard's impact.

### *The Theory of Political Costs*

This study is based on the Theory of Political Costs, as proposed by Zimmerman (1983). The political costs' hypothesis takes size as a proxy for political visibility, predicting that large companies are more likely to choose accounting methods that reduce reported

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

profits, in order to avoid drawing authorities' attention (ZIMMERMAN, 1983; WATTS; ZIMMERMAN, 1990).

In short, this theory is grounded in the notion that big companies adopt practices aimed at reducing their profits, by means of various accounting methods, thus it avoids drawing government's attention to their success. This is because, hypothetically, a company or sector that enjoys high profit margins warns the government, which may choose a stricter regulation or even increase the tax burden on the industry.

So, a tax burden that impacts companies is one of the political cost components (ZIMMERMAN, 1983). According to this author, some studies show that, as they are more subject to government scrutiny, large companies adopt accounting practices to reduce the most usual form of profits, in order to reduce this political cost.

Zimmerman (1983) justifies that the inclusion of tax burden as a political cost component derives from an explicit attempt to redistribute wealth by political authorities. It is worth saying that, in theory, wealth redistribution is sought to achieve a balance between taxpayers with greater ability to pay taxes and the others. In addition, according to Zimmerman (1983), high profit margins signal a company's success, which may warn the government about the opportunity for regulatory innovation or increased tax burden.

Watts and Zimmerman (1978) also predict that managers have great incentives to choose accounting standards that report lower revenues. The reason is that the choice of standards to reduce a company's revenues increases cash flow, e.g., due to reduced taxes on profit.

The Theory of Political Costs and its tax component in Brazil is illustrated below, by means of the explanatory memoranda in the Provisional Act no. 413/2008 – which increased the Brazilian social contribution on net profits (CSLL) for banks from 9% to 15% – providing that

The proposed act [...] aims to establish a tax rate compatible with the contributory capacity of the economic sectors covered. These sectors have shown strong dynamics, growth, and profitability, brought by the country's economic growth, as a result of the macroeconomic measures adopted.

It is claimed that the adoption of a high tax rate for banks is due to the fact that this sector has high profit margins, just as the press reported at that time – in a clear demonstration of adequacy of the Theory of Political Costs.

It may also be claimed that the amounts payable to public coffers are not affected only by laws that directly change a company's tax burden. There is no doubt that accounting standards can also affect the recognition of economic events, which may influence the companies' cash flow, highlighting taxes (WATTS; ZIMMERMAN, 1978).

On the other hand, organizations may resort to political lobbying to avoid tax laws or accounting standards that affect their cash flow, and this expense is also a political cost component. Watts and Zimmerman (1978), however, claim that, as a general standard, large companies have a reasonable experience in reducing their profits. Thus, contrary to what occurs with other companies, they are not opposed to changes in accounting standards, as long as the cost of the opposite lobbying exceeds the additional tax or accounting costs involved. So, it is reasonable to infer that, according to this rationale,

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

companies confronted by a new standard may resort to reducing profits in order to avoid any impact due to its validity.

So, Alchian and Kessel (1962) notice that companies controlling a large portion of the market, thus obtaining excessive profits, are afraid that public policies or State actions are aimed against them. Hence, companies may avoid disclosing information that potentially warns authorities about themes that are key to them, just as the tax burden.

In short, the accounting policies are not defined just in terms of technical criteria, but they also tend to be subject to some opportunistic bias by organizations. Therefore, a company defines its accounting practices according to their consequences, and political cost is one of the elements affecting this decision.

### Methodological procedures

#### *Research problem*

Blouin *et al.* (2007) argue that when a corporation files its tax return, it often pays less tax than due, and the courts may ask if various positions related to exclusions, deductions, credits and valuations were challenged. Similarly, Greco (2011) states that many of the big Brazilian companies do not pay taxes as a result of tax planning. Accepting these claims as true, greater transparency is expected in companies' tax positions, and the details of tax planning can cause high political cost, insofar as they may draw tax authorities' attention. Thus, the business sector may undergo greater regulation to hinder such planning or even increased tax rates.

Frischmann, Shevlin and Wilson (2008) mention that, when the FIN 48 was issued, the U.S. Senate sent a request to several companies to ask for additional information about transactions associated with disclosure of their tax positions. This clearly demonstrates that this standard had the effect of drawing politicians' attention to tax positions taken by corporations.

This scenario is consistent with the assumption that companies may be willing to change their behavior after the FIN 48 was issued, avoiding to draw authorities' attention to the uncertainty of their tax positions. This behavioral change might lead to the adoption of rather conservative practices and, as a consequence, increased profits and taxes on profits.

On the other hand, according to the Theory of Political Costs, an increase in calculated profits has the potential to draw the political class's attention. According to Holthausen and Leftwich (1983), disclosure of accounting figures have economic consequences for corporations with political visibility – as reported values increase the likelihood of increased amount of taxes or extinction of subsidies.

Therefore, paradoxically, the adoption of less aggressive tax planning practices leads to increased profits, which, according to the Theory of Political Costs, is a vector that draws government's attention. In short, the FIN 48 generates a serious conflict of choice for companies: adopting less aggressive tax practices and increasing reported profits, even drawing government's attention, or keeping the methods adopted so far with regard to their tax positions and drawing tax authorities' attention to tax avoidance/evasion practices.

#### *Research question, objective and hypotheses*



## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

The general aim of this paper is assessing the decision made by Brazilian companies, considering the trade-off introduced in the previous section. This study was guided by a research question: “What is the position taken by Brazilian companies when faced with the obligation to comply with the FIN 48, considering the increased risk of tax audits, from the perspective of the Theory of Political Costs?”

This study seeks to evaluate the FIN 48 adoption by Brazilian companies listed on the New York Stock Exchange (NYSE), at the time of its publication; it made an impact on companies' behaviour when observing the figure for tax on profits. The established research hypotheses analyse two variables related to tax positions that may have been affected by the FIN 48 adoption. The variables in focus are taxes on corporate profits, *i.e.*, IR and CSLL, analysed together and referred to as Brazilian income tax and social contribution (IRCS). Both are income taxes and differ just by destination – the second is a tax paid to the social security system.

The IRCS is discussed in detail into two parts, *i.e.*, current IRCS and net current IRCS. Current IRCS concerns the amount of taxes including deferred tax amounts (assets and liabilities), arising from deductible and taxable temporary differences in the following fiscal years (SFAS 109). Net current IRCS concerns a tax with IRCS recognized and accounted for in the very period when the profit took place (SFAS 109). The adjective *net* refers to exclusion of the deferred portion.

The hypotheses developed in this study are:

- **Hypothesis 1:** The FIN 48 adoption had no impact on the amount of current IRCS.
- **Hypothesis 2:** The FIN 48 adoption had no impact on the amount of net current IRCS.

The null hypothesis tested is that the FIN 48 adoption had no impact on the amount of the variables under analysis. Studies of variables and tests of hypotheses enable us to evaluate the tax position of Brazilian companies regarding the disclosure of taxes in financial statements (current and deferred), before and after the introduction of specific criteria through the FIN 48.

### *Research Method*

#### Data collection

This study analysed the financial statements of Brazilian companies issuing American depositary receipts (ADRs) within the periods 2004, 2005 and 2006 (*i.e.*, before the standard was adopted), 2007, 2008 and 2009 (*i.e.*, after its adoption). The sample consisted of 20 companies, namely: AmBev, Aracruz, Braskem, Cemig, Copel, CPFL Energia, CSN, Embraer, Fibria, Gerdau, Gol, Oi, CBD (Grupo Pão de Açúcar), Petrobras, Sadia, Telefónica Brasil, Tim, Ultrapar, Vale, and Vivo. In order to perform a more comprehensive evaluation of the two hypotheses, statistical tests were performed involving 1-, 2- and 3-year periods before/after the standard came into force. Longer periods result in too-small samples, as Brazilian companies gradually started to adopt the IFRS since 2008.

A FIN 48 impact would be expected only if it were applicable. Therefore, only financial statements with U.S. GAAP reconciliation were considered, which led to the exclusion of some observations from the final sample. Since 2008, the U.S. GAAP reconciliation requirement was removed by SEC for foreign private issuers that file their

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

financial statements with the commission using the IFRS as issued by the IASB (SEC Release No. 33-8879/2007). For more details about the companies considered, see Appendix A.

Data was obtained from the system *Economática*, which provides information on capital markets of the main Latin American economies and the USA – it has been processed by using a licensed version of the system *Economática*, provided by the School of Economics, Business and Accounting of the University of São Paulo (FEA/USP), and checked through the SEC database.

Notes on the tests performed.

The analysis aimed to identify whether there are significant differences in the amount of current taxes and net current taxes calculated on Brazilian companies' profits between the periods before and after the FIN 48 validity. Thus, it requires a comparison between financial statements of companies included in the sample. However, it is worth noticing that absolute values obtained may be significantly different in terms of 'size' between various companies, and this situation might lead to distortions in statistical analysis. Brown, Lo and Lys (1999) reported that statistical analysis should take into account the scale factor and its impact on findings.

As this study analyses behaviour rather than absolute numbers, the variables in focus refer to net revenues for the fiscal year (variable/net revenues). This procedure has two purposes: first, it is intended to purge the inflation effects (FAMA, 1981; GONEDS, 1981), since there could be increased tax revenues due to inflation, and not because of the standard; second, increased or decreased tax collection could derive from economic activity (e.g., higher net revenue implies higher tax collection), with no relation to the standard.

### *Data processing and results*

To meet the purposes of this study, hypothesis testing was applied, which, according to Fávero *et al.* (2009), consists of a method that enables checking whether the sampling data provide evidence to support a particular hypothesis formulated.

Considering the aim of this research, *i.e.*, comparing an earlier period to another after the FIN 48 adoption, and since both samples are taken from the same group of companies, *i.e.*, they are two paired samples, the test of choice must be consistent with this purpose. A preliminary analysis of companies pointed out that, for some of them, the requirement to use parametric tests (*t*-test) has not been complied with, because such tests follow the normality assumption – this was not found by using Kolmogorov-Smirnov and Shapiro-Wilk tests (Table 1).

**Table 1: Normality test of the 1-year period before/after FIN 48 adoption**

	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistics	D.f.	P value	Statistics	D.f.	P value
IRCS_Current_before	0.164	20	0.162	0.911	20	0.067
IRCS_NetCur_before	0.158	20	0.200	0.894	20	0.032
IRCS_Current_after	0.132	20	0.200	0.948	20	0.331
IRCS_NetCur_after	0.267	20	0.001	0.848	20	0.005

Source: The author.

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

As an alternative to parametric Student's *t*-test, the non-parametric Wilcoxon test for two paired samples was used, which does not require normality as an assumption. In turn, homogeneity testing of variances (Levene's test) was not performed, since the samples are paired.

Descriptive statistics for samples considering the variable current and net current IRCS are shown in Table 2. See Appendix B for descriptive statistics and normality tests for 2- and 3-year periods before/after the FIN 48 adoption.

**Table 2: Descriptive statistics – (net) current tax (1-year period before/after sample)**

Descriptive statistics				
	N	Mean		Std. deviation
	Statistics	Statistics	Std. error	Statistics
IRCS_Current_before	20	0.0365407	0.0095387	0.0426584
IRCS_NetCur_before	20	0.0339273	0.0088808	0.0397163
IRCS_Current_after	20	0.0435159	0.0089620	0.0400794
IRCS_NetCur_after	20	0.0447088	0.0083831	0.0374903

Source: The author.

Data analysis was performed by using the software *SPSS*<sup>®</sup>, version 21.

### Analysis of results

Considering the methodology for data collection and analysis, this topic analyses the hypotheses raised in the light of the theoretical framework.

- **Hypothesis 1:** The FIN 48 adoption had no impact on the amount of current IRCS.

The result of Wilcoxon test for paired samples led to a calculated *p* value of 0.218, therefore, higher than the 0.05 (5%) significance level, something which leads to the confirmation of hypothesis 1, *i.e.*, there were no significant changes in the amount of current IRCS declared in financial statements of the sample. Analytically, it was observed that 12 observations had an increase in the variable current IRCS, while the other 8 had a decrease.

- **Hypothesis 2:** The FIN 48 adoption had no impact on the amount of net current IRCS.

Again, the *p* value calculated, 0.079, was higher than the 0.05 significance level, something which proves hypothesis 2, *i.e.*, there were no significant changes in the amount of net current IRCS declared in financial statements of the sample. Analytically, it was noticed that 13 observations experienced an increased variable net current IRCS, while the others decreased.

Applying the Wilcoxon test for 2- and 3-year periods before/after the FIN 48 adoption also confirms the two hypotheses. Table 3 shows the results for the 3 study samples.

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

**Table 3: Results of Wilcoxon test for paired samples**

Sample	N observations	Variable	P value
1-year period	20	IRCS current	0.218
		IRCS net current	0.079
2-year period	34	IRCS current	0.871
		IRCS net current	0.952
3-year period	30	IRCS current	0.959
		IRCS net current	0.943

Source: The author.

For the purposes of comparison and analysis, parametric Student's *t*-test was performed on the 2-year period sample. As  $N > 30$ , failing to observe the normality assumption is accepted, so that parametric Student's *t*-test for paired samples may be used. As showed in Table 4, the results led to calculated *p* values of 0.513 (current IRCS) and 0.465 (net current IRCS), which lead to confirmation of both hypotheses – the same conclusion obtained by using the non-parametric Wilcoxon test.

**Table 4: T-test for paired 2-year period samples**

	Paired differences					T	D.f.	Sig. (2-tailed)
	Mean	Std. deviation	Std. error Mean	95% Confidence interval of the difference				
				Lower	Upper			
IRCS current	0.0081055	0.0714843	0.0122594	-0.0168365	0.0330476	0.661	33	0.513
IRCS net current	-0.0038594	0.0304602	0.0052238	-0.0144875	0.0067686	-0.739	33	0.465

Source: The author.

The results reveal that Brazilian companies subject to comply with the FIN 48 did not adopt, as a consequence of the standard, rather conservative tax practices that might result in increase in the amounts calculated as taxes on profit, aligned with the findings by Blouin *et al.* (2007) for U.S. companies. Findings rule out the hypothesis that companies adopt rather conservative practices for fear that the standard, by requiring greater disclosure of uncertain tax positions, may increase the risk of scrutiny by tax authorities, and, as a consequence, there might be an increase in companies' tax burden. This was determined by noticing that the calculated amount of taxes on profits had no statistically significant increase when compared to the periods before and after the FIN 48 validity.

Therefore, the research question is answered in the sense that companies have adopted a position consistent with the Theory of Political Costs (ZIMMERMAN, 1983). The companies under study have not deployed rather conservative practices that led to an increase in reported profits, something which showed that the awe that the standard may facilitate the realization of inspection procedures by fiscal organs was not enough to change their behaviour.

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

### Conclusion

This study aimed to evaluate the FIN 48 impacts on the amount of taxes on profits of Brazilian companies, *i.e.*, comprising current IRCS and net current IRCS.

The standard's scope is establishing guidelines for accounting and companies' disclosure of tax on profits, especially those related to uncertain positions declared in financial statements. By requiring greater transparency regarding uncertain tax positions, the FIN 48 caused, among companies and accounting practitioners, the awe that it may increase the risk for scrutiny by fiscal organs, due to ease of access to the tax practices.

As a result of this concern, it was theorized that companies may adopt rather conservative tax procedures, aiming to reduce the risk for tax assessment, something confirmed by studies conducted with U.S. corporations. Indeed, such rather conservative practices imply an increase in corporate profits, thus in the amount of taxes on profits. However, this finding is contrary to the Theory of Political Costs, as proposed by Zimmerman (1983), which predicts that companies adopt accounting practices to reduce the amount of profits, with a view on trying to avoid drawing government's attention, thus not stimulating any sector regulation or increase in the tax burden.

This study found out that, when comparing different  $n$ -year periods before and after the standard validity, there was no statistically significant change in the amount of taxes calculated on profits for Brazilian companies subject to compliance with the FIN 48. Thus, it is noticed that the assumption that companies adopt rather conservative tax practices with a consequent increase in the tax burden did not apply, but the hypothesis proposed by the Theory of Political Costs was confirmed (ZIMMERMAN, 1983), *i.e.*, corporations adapt to accounting regulations in order to prevent an increase in reported profits, with a view to avoid drawing government's attention.

So, it is concluded that the FIN 48 did not produce a statistically significant impact on the amount of taxes calculated on profits for Brazilian companies subject to compliance with it, something which shows that the awe that the standard could increase the risk of enforcement was not enough for any behavioural change among companies, something which reinforces the assumption proposed by the Theory of Political Costs.

The contribution of this study is fourfold. First, it addresses a major research issue, providing a better answer to a question with no scientific consensus. Second, using the Theory of Political Costs approach innovates the theoretical framework, as it sheds light on the reasons why there was no statistically significant change in the amount of income taxes after the FIN 48 adoption. Third, this is a topic under discussion worldwide, especially considering the studies conducted by the OECD within the BEPS. Finally, the results can help the prediction about the consequences of adoption of IFRIC 23 in Brazil.

Considering the limitations of this study, in terms of sample size and test types, it is recommended to carry out further studies on the theme. Particularly, it is suggested to use other statistical techniques, which tend to control different latent variables that may bias outcomes. Prospective research may provide knowledge by using a meta-analysis of previous studies.



## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

### References

- ALCHIAN, A.; KESSEL, R. Competition, monopoly and the pursuit of money. National Bureau of Economic Research. **Aspects of Labor Law**, p. 157-175, 1962.
- BECK, P.; LISOWSKY, P. Tax Uncertainty and Voluntary Real-Time Tax Audits. **The Accounting Review**, v. 89, no. 3, p. 867-901, 2014.
- BLOUIN, J. L.; GLEASON, C. A.; MILLS, L. F.; SIKES, S. A. What can we learn about uncertain tax benefits from FIN 48? **National Tax Journal**, v. 60, p. 521-535, 2007.
- BLOUIN, J.; ROBINSON, L. Insights from the initial post-implementation review of FIN 48. **Papers SSRN**, p. 1-32, 2013. Retrieved at <http://ssrn.com/abstract=2364809>. Accessed on Dec 11, 2013.
- BROWN, S.; LO, K.; LYS, T. Use of R2 in accounting research: measuring changes in value relevance over the last four decades. **Journal of Accounting and Economics**, v. 28, p. 83-115, 1999.
- DUBIN, E.; WATTS, A. B. Could FIN 48 have contributed to an increase tax compliance among non-filers? **Multistate Tax Commission Review**, v. 20, no. 4, p. 07-14, 2009.
- FAMA, E. F. Efficient capital markets: a review of theory and empirical work. **Journal of Finance**, v. 25, no. 2, p. 83-417, 1970.
- FAMA, E. F. Stock returns, real activity, inflation, and money. **American Economic Review**, v. 71, p. 545-565, 1981.
- FASB. **Post-Implementation Review Report on FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes**. Norwalk, CT: FAF, 2012.
- FÁVERO, L. P.; BELFIORE, P.; SILVA, F. L.; CHAN, B. L. **Análise de dados: modelagem multivariada para tomada de decisões**. Rio de Janeiro: Elsevier, 2009.
- FRISCHMANN, P.; SHEVLIN, T.; WILSON, R. Economic consequences of increasing the conformity in accounting for uncertain tax benefits. **Journal of Accounting and Economics**, v. 46, no. 2/3, p. 261-278, 2008.
- GONEDES, N. Evidence on the tax effects of inflation under historical cost accounting methods. **Journal of Business**, v. 54, p. 227-270, 1981.
- GOULART, J. Regra da SEC facilita ação da Receita (translation: SEC rule facilitates inspection of Brazilian tax authority). **Valor Econômico**. 2007. Available at [http://www.icbrasil.com.br/noticias/ver.asp?not\\_id=1671](http://www.icbrasil.com.br/noticias/ver.asp?not_id=1671). Accessed on May 21, 2016.
- GRECO, M. A. **Planejamento tributário**. 3rd. ed. São Paulo: Dialética, 2011.

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

GUPTA, S.; MILLS, L. A.; TOWERY, E. Did FIN 48 arrest the trend in multistate tax aggressiveness? **McCombs Research Paper Series**, No. ACC-10-09, p. 1-43, 25 Nov. 2009. Available at <http://ssrn.com/abstract=1477068>. Accessed on Dec 11, 2013.

HOLTHAUSEN, R. W.; LEFTWICH, R. W. The economic consequence of accounting choice: Implications of costly contracting and monitoring. **Journal of Accounting and Economics**, v. 5, p. 77-117, 1983.

KERN, B.; LUTTMAN, S. Uncertain state tax position financial statement disclosures under FIN 48 and the new Internal Revenue Service Schedule UTP. **Journal of State Taxation**, v. 29, no. 2, p. 53-56, 2011.

LEV, A. M. FIN 48 Creates unexpected risks in business sales. **The M&A LAWYER**, v. 12, p. 2-7, July/Aug. 2008.

LISOWSKY, P. Seeking shelter: empirically modeling tax shelters using financial statement information. **The Accounting Review**, v. 85, no. 5, p. 1693-1720, 2010.

LISOWSKY, P.; ROBINSON, L. A.; SCHMIDT, A. Do publicly disclosed tax reserves tell us about privately disclosed tax shelter activity? **Journal of Accounting Research**, v. 51, no. 3, p. 583-629, 2013.

MILLS, L. F.; ROBINSON, L. A.; SANSING, R. C. FIN 48 and tax compliance. **The Accounting Review**, v. 85, no. 5, p. 1721-1742, 2010.

NICHOLS, N. B. One year later: an analysis of FIN 48 disclosures in 2007 forms 10-k. **Tax Notes**, v. 121, no. 5, p. 555-562, 2008.

OECD. Explanatory Statement. OECD/G20. *Base Erosion and Profit Shifting Project*. Paris: OECD, 2015. Available at [www.oecd.org/tax/beps-explanatory-statement-2015.pdf](http://www.oecd.org/tax/beps-explanatory-statement-2015.pdf). Accessed on May 21, 2016.

ROBINSON, L. A.; SCHMIDT, A. Firm and investor responses to uncertain tax benefit disclosure requirements. **Journal of the American Taxation Association**, v. 35, no. 2, p. 85-120, 2013.

SONG, W.-L.; TUCKER, A. L. Corporate tax reserves, firm value, and leverage. **San Francisco Meetings Paper**, p. 1-33, 2008. Available at <http://ssrn.com/abstract=1086827>. Accessed on Dec 11, 2013.

TOMAHARA, A.; LEE, H. J.; LEE, S. Did FIN 48 increase companies' tax payments? Trade-off between disclosure and tax burdens. **Applied Economics**, v. 44, p. 32, p. 4239-4248, 2012. Available at <https://doi.org/10.1080/00036846.2011.587789>. Accessed on May 21, 2016.

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

WATTS, R. L.; ZIMMERMAN, J. Towards a positive theory of the determination of accounting standards. **The Accounting Review**, v. 53, p. 112-134, 1978.

WATTS, R. L.; ZIMMERMAN, J. L. Positive accounting theory: a ten year perspective. **The Accounting Review**, v. 65, n. 1, p. 131-156, 1990.

ZIMMERMAN, J. L. Taxes and firm size. **Journal of Accounting and Economics**, v. 5, p. 119-149, 1983.

### Appendix A

**Table A.1: Companies and financial statements used in statistical analysis**

Company	SEC number (CIK)	Year(s) after/before		
		1	2	3
AmBev Co.	0001113172	x		
Aracruz Cellulose S.A.	0000883952	x	x	
Braskem S.A.	0001071438	x	x	
Minas Gerais Energy Co.	0001157557	x	x	x
Paraná Energy Co.	0001041792	x	x	x
CPFL Energy Inc.	0001300482	x	x	
National Steel Co.	0001049659	x	x	x
Embraer S.A.	0001355444	x	x	
Fibria Cellulose S.A.	0001110649	x	x	x
Gerdau S.A.	0001073404	x		
Gol Intelligent Airlines Inc.	0001291733	x		
Oi S.A.	0001160846	x	x	x
CBD (Grupo Pão de Açúcar)	0001038572	x	x	
Petrobras S.A.	0001119639	x	x	x
Sadia S.A.	0001130968	x	x	
Telefónica Brasil S.A.	0001066119	x	x	
TIM Participações S.A.	0001066116	x	x	x
Ultrapar Holdings Inc.	0001094972	x	x	x
Vale S.A.	0000917851	x	x	x
Vivo Participações S.A.	0001071337	x	x	x
<b>TOTAL</b>		<b>20</b>	<b>17</b>	<b>10</b>

Source: The author.

**THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES**

Appendix B

**Table B.1: Descriptive statistics – (net) current tax (2-year period before/after sample)**

Descriptive statistics				
	N	Mean		Std. deviation
	Statistics	Statistics	Std. error	Statistics
IRCS_Current_before	34	0.0328501	0.0065391	0.0381295
IRCS_NetCur_before	34	0.0356523	0.0065351	0.0381060
IRCS_Current_after	34	0.0247445	0.0130032	0.0758214
IRCS_NetCur_after	34	0.0395117	0.0065056	0.0379342

Source: The author.

**Table B.2: Normality tests (2-year period before/after sample)**

Normality tests						
	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistics	D.f.	Sig.	Statistics	D.f.	Sig.
IRCS_Current_before	0.129	34	0.168	0.950	34	0.126
IRCS_NetCur_before	0.135	34	0.120	0.937	34	0.051
IRCS_Current_after	0.230	34	0.000	0.728	34	0.000
IRCS_NetCur_after	0.220	34	0.000	0.861	34	0.000

Source: The author.

**Table B.3: Descriptive statistics – (net) current tax (3-year period before/after sample)**

Descriptive statistics				
	N	Mean		Std. deviation
	Statistics	Statistics	Std. error	Statistics
IRCS_Current_before	30	0.0408945	0.0071593	0.0392132
IRCS_NetCur_before	30	0.0434182	0.0070946	0.0388592
IRCS_Current_after	30	0.0410507	0.0108504	0.0594303
IRCS_NetCur_after	30	0.0455774	0.0070048	0.0383670

Source: The author.

**Table B.4: Normality tests (3-year period before/after sample)**

Normality tests						
	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistics	D.f.	Sig.	Statistics	D.f.	Sig.
IRCS_Current_before	0.099	30	0.200	0.932	30	0.056
IRCS_NetCur_before	0.127	30	0.200	0.926	30	0.038
IRCS_Current_after	0.153	30	0.071	0.820	30	0.000
IRCS_NetCur_after	0.156	30	0.062	0.895	30	0.006

Source: The author.

## THE DEMAND FOR GREATER TRANSPARENCY IN ACCOUNTING TAX POSITIONS: ANALYSING THE FIN 48 ADOPTION BY BRAZILIAN COMPANIES

### AUTORES:



#### **Fabio Pereira da Silva**

Mestre e Doutorando em Controladoria e Contabilidade (PPGCC) pela FEA/USP. Atuou como Coordenador do MBA de Gestão Tributária da FIPECAFI; Professor da FGV - Fundação Getúlio Vargas do Programa de Pós-graduação em Direito Tributário; Professor no Insper no LLM em Direito Tributário e Societário; Professor da Graduação em Ciências Contábeis na FIPECAFI na disciplina de Contabilidade Tributária; Professor do MBA de Gestão Tributária da FIPECAFI. Autor do Livro: Holding Familiar: aspectos jurídicos e contábeis do planejamento patrimonial da Editora Atlas; Organizador dos livros Manual de Gestão Tributária: Teoria e Prática e Controvérsias Jurídico-Contábeis, da Editora Atlas. Especialista em Direito Tributário pela FGV - Fundação Getúlio Vargas; Especialista em Direito Empresarial pela Universidade Presbiteriana Mackenzie; Pós Graduado em Business Management com ênfase em finanças na UCSD - University of California, San Diego (2011). Advogado Tributarista em São Paulo. E-mail: blogsuaeconomia@gmail.com FEA-USP. São Paulo. Brasil



#### **Reinaldo Guerreiro**

Mestre, Doutor e Livre-Docente pela Universidade de São Paulo (FEA-USP). Professor Titular da Universidade de São Paulo (FEA-USP). Foi Diretor da FEA-USP de 2010 a 2014. É atualmente Presidente do Conselho Curador da Fundação Instituto de Pesquisas Contábeis, Atuariais e Financeiras – FIPECAFI. Presidente do Comitê de Auditoria da Petrobrás Gás S.A. – Gaspetro de 2018 a 2021. Membro do Conselho de Administração da Cia. de Saneamento Básico do Estado de São Paulo - SABESP de 2007 a 2020. Membro do Conselho de Administração da Petrobrás Distribuidora S.A. de 2016 a 2018. Membro do Comitê Estratégico da empresa Petróleo Brasileiro S.A. – Petrobras de 2016 a 2018. Liderou a concepção e o desenvolvimento de sistemas de apuração de custos em muitas empresas de grande porte e de diferentes setores de atividade (Banco do Brasil, Correios, CEF, Previ, etc.). Autor ou coautor de diversos livros da área de contabilidade gerencial. Autor ou coautor dezenas de artigos publicados em periódicos nacionais e internacionais. E-mail: reiguerr@usp.br FEA-USP São Paulo Brasil



#### **Denis Mângia**

Possui graduação em Engenharia Elétrica/Eletrônica pela Universidade Federal de Itajubá - UNIFEI (2002). Possui mestrado em Engenharia Eletrônica e Computação pelo Instituto Tecnológico de Aeronáutica - ITA (2005). Também é mestre em Contabilidade e Controladoria pela FEA/USP na linha de Controladoria e Contabilidade Gerencial (2015). Em 2006 ingressou no serviço público, exercendo o cargo de Auditor-Fiscal de Tributos Estaduais na Secretaria da Fazenda do Amazonas (2006 - 2010). Atualmente é Auditor Fiscal da Secretaria da Fazenda e Planejamento do Estado de São Paulo (SEFAZ/SP) e cursa Economia na FEA/USP (2018-2022). E-mail: denis.maciell@usp.br FEA-USP. São Paulo. Brasil